

CIAOER
Economic Intelligence Weekly

EW 75-07-30

Approved For Release 2000/09/14 : CIA-RDP86T00608R000500140030-0

30 Jul 75

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Economic Intelligence Weekly

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ER EIW 75-30
30 July 1975

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Classified by 115319
Exempt from general declassification schedule
of E.O. 11652, exemption category:
§ 5B(1), (2), and (3)
Automatically declassified on:
Date Impossible to Determine

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ECONOMIC INTELLIGENCE WEEKLY

30 July 1975

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Overview

With unemployment rising steadily, reflationary strategy will be the theme of the upcoming four-power talks in Helsinki. The economic leaders of the United States, West Germany, France, and the United Kingdom will be seeking ways to turn around global recession without intensifying inflation and payments problems. After waiting for months for export-led growth to lead them out of the slump, the West Europeans, led by the Germans and the French, now are pushing for a policy of coordinated reflation.

Following their meeting last week, Chancellor Schmidt and President Giscard announced plans to increase public spending in the coming months. The Germans and the French intend to raise public works outlays by amounts equal to 2% and to 4% of total 1974 investment. Meanwhile, the EC Commission has joined the reflation chorus by calling for six of its nine members to take pump-priming action.

The coordination of positions on monetary issues is proving difficult for the West Europeans. The French continue to press for fixed exchange rates, arguing that floating rates are largely responsible for recent economic dislocations. [REDACTED]

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Continued severe drought in most of the USSR's spring grain land has led us to reduce our estimate of the 1975 crop to 185 million tons. In response, the Soviets have purchased 14.5 million tons of grain, two-thirds from US dealers. They are likely to return to the market later this year. These large purchases, combined with increased imports of machinery and equipment, could result in a record \$3 billion hard currency trade deficit this year. Although they would not accept so large a deficit for an extended period, the Soviets will have no difficulty in financing this level in 1975.

In contrast to the USSR, China can look forward to a 1975 grain crop exceeding the record 255 million tons of last year. This estimate assumes at least average weather for the important fall-harvested crop. China in this case is not likely to require much more than the 4 million tons of wheat already booked for delivery from Canada and Australia under long-term contracts.

International grain prices have strengthened and are expected to remain strong in the wake of Soviet purchases. Since 1 July wheat prices have risen 30%, to \$4.00 a bushel; corn and soybean prices are up by 13% and 22%, respectively. The markets will remain subject to short-run price pressures because of uncertainties about further Soviet purchases, the size of the US corn harvest, and weather problems in Europe and the southern hemisphere. (Secret No Foreign Dissem)

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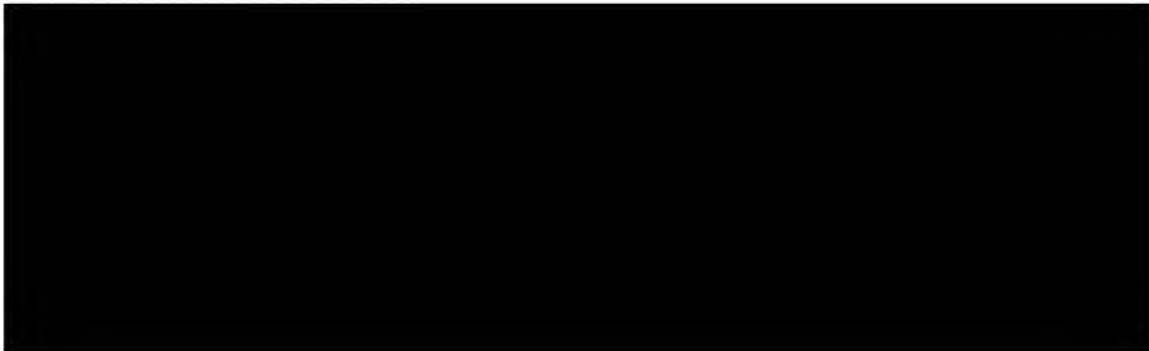
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USSR: GRAIN PROSPECTS DARKEN

Because of continued severe drought in most of the USSR's spring grain land, we have cut our estimate of the 1975 crop to 185 million tons. The worsening of prospects has prompted Moscow to order 14.5 million tons of grain, two-thirds from US grain dealers.

Effects of Drought

The drought has been even more widespread than in 1972, and as a result, the spring grain harvest probably will be lower. The expected record harvest of winter grains, however, should ensure a total crop substantially above the disastrous 1972 harvest of 168 million tons, which led to imports of about 30 million tons.

Our current crop forecast is 15 million tons under our prediction at the end of June. If the drought continues, the prospects for the harvest of spring grains that have not yet matured, such as corn, will worsen. Problems exist for other crops - particularly forage crops - in the drought-stricken area.

Short of Requirements

The grain crop this year will be well under the normal grain requirement of about 210 million tons. Although the USSR has ordered large quantities of foreign grain, it will not necessarily try to fill the entire gap with imports. Rather, it is likely to dip to some extent into grain reserves. Livestock could be slaughtered to curb grain demand, but the high priority of General Secretary Brezhnev's meat program makes this option unattractive.

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Of the 14.5 million tons of grain recently purchased by the USSR, 9.8 million tons are contracted from US companies and will be filled largely from the US crop. The other contracts are with Canada, Australia, and France. Moscow may soon withdraw from the market to assess the evolution of both its own crop and world supplies. A new round of Soviet buying is likely later. (Confidential)■

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CHINA: THE GRAIN OUTLOOK AT MIDYEAR

The Chinese grain crop will top the record 255 million tons harvested last year, if average weather holds throughout the remainder of the growing season. We judge that China is not likely to require much more than the 4 million tons of wheat already booked for 1975 delivery from Canada and Australia.

Summer-harvested grain -- which accounts for one-fifth of China's output -- set a record this year according to a Peking broadcast [REDACTED]

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[REDACTED]. Of key importance were excellent harvests of winter wheat and barley in North China. Lentils, barley, and sweet potatoes (treated as a grain in Chinese statistics) did less well in most of South China because of damp, cool weather.

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Early rice -- which also accounts for about one-fifth of China's grain -- is not yet ready for harvest. Peking has been unusually vague about the crop thus far, which suggests that prospects are unfavorable. The poor weather that affected much of South China earlier in the year held back plant growth. As a consequence, the early rice harvest is likely to fall short of the exceptionally good crop in 1974.

Fall-harvested grain -- normally three-fifths of the total -- is off to a good start, but the size of the fall harvest will be largely determined by the weather over the next two months. Growing conditions have been favorable with the exception of Northeast China, where crops were held back by spring drought. Normal weather over the balance of the growing season should enable the Chinese to produce an autumn crop well above last year's poor crop. (Secret No Foreign Dissem)■

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USSR: RECORD HARD CURRENCY TRADE DEFICIT IN 1975

The USSR in 1975 will incur the largest hard currency deficit in its history -- perhaps on the order of \$3 billion. Imports of Western equipment and grain will be up substantially, and export growth will be negligible because of recession in the West. The USSR will have no difficulty in financing this anticipated deficit by gold sales and credits.

Trade in 1974

The situation is in marked contrast to 1974, when the Soviet Union incurred a \$900 million hard currency deficit. Higher prices for key Soviet exports led to a 58% increase in hard currency earnings -- to \$7.6 billion; imports were up 30% -- to \$8.5 billion. A decline of \$1 billion in food imports in 1974 was overridden by a \$3 billion rise in other imports.

Changes in Pattern of Trade

The USSR ran a substantial surplus with the developed countries in the first three quarters of 1974 as a result of surging prices for oil and raw materials. This pattern changed dramatically in the fourth quarter, when Soviet imports rose rapidly and exports turned down. Both developments reflected the growing recession in the West. The growth in imports was led by steel, as Western firms became more willing to fill longstanding Soviet orders. The decline in Soviet export earnings stemmed from a fall in Western demand and in the prices for many Soviet products.

Since October 1974, the USSR has incurred monthly trade deficits with its principal Western partners. Continuation of this pattern would result in a Soviet deficit of \$3 billion or more in hard currency trade.

Such a deficit would reflect the following factors.

- The large volume of Soviet contracts for Western plant and equipment placed in 1973 and 1974 will result in increased imports of machinery and equipment of \$1 to \$1.5 billion this year -- to a level of \$3.3 to \$3.8 billion.

- Recent contracts for Western grain will bring Soviet grain imports in calendar year 1975 to roughly \$1 billion - double the 1974 level. Moreover, additional Soviet grain purchases are likely, perhaps some for 1975 delivery.
- Increases in sugar imports will exceed decreases in meat imports by about \$200 million.
- Imports of steel products will approximate last year's high level of \$1.9 billion.
- The continuing Western recession will make it difficult for the USSR to increase its hard currency exports.

Financing the Deficit

Moscow is in good shape to finance a deficit of \$3 billion in 1975.

- Its cash position improved in 1974 despite the trade deficit. The Soviets sold roughly \$700 million in gold, obtained a net of \$600 million in medium- and long-term credits, and earned several hundred million dollars from arms sold to the Middle East following the October 1973 war. The strengthened Soviet position was illustrated by a \$600 million improvement in the USSR's short-term position on the London Eurocurrency market.
- A large part of the Western machinery and equipment delivered in 1975 will be covered by long-term credits. Net credits should exceed \$1.4 billion.
- Moscow has already obtained \$350 million in medium- and long-term Eurocurrency loans since December. Western bankers say that the Soviets could raise substantially more on the Eurocurrency market.
- The USSR has lots of gold to sell. It produces more than 300 tons of gold annually and has more than six times that amount in reserves. Sixty-two tons, worth \$325 million, reportedly were sold in the West in the first half of 1975, and an additional 50-ton sale direct to Arab

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buyers has been rumored. Soviet sales during the balance of the year could rise considerably without depressing prices, if South Africa reduces its marketings, as expected.

By late 1975 or early 1976, Soviet exports should resume their growth in response to the expected recovery of the Western economies from the recession. It is probable that Moscow will then give priority to cutting the trade deficit rather than to further expanding imports in order to avoid a serious worsening of its debt position. (Secret No Foreign Dissem)■

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SPAIN REACTS TO PAYMENTS PROBLEMS

Despite its strong reserve position, Madrid is considering import controls to check the continuing deterioration in its trade balance.

If imports are not curbed, the current account deficit will reach an estimated \$3 billion in 1975, up from \$2.5 billion last year. Spain could finance the prospective deficit by borrowing abroad and drawing on its \$5-1/2 billion in foreign reserves. The leadership's financial conservatism suggests an unwillingness to rely more heavily than last year on these expedients. Prime Minister Arias also has decided against austerity measures to contain import demand because the economy has already slowed to a crawl and labor tensions are high.

The Current Account Gap

Unlike many other oil-importing countries, Spain so far has done little or nothing to offset the impact of higher oil prices. Its trade deficit, which jumped from \$3.5 billion in 1973 to \$6.8 billion in 1974, has continued to grow this year. Although higher oil prices were largely responsible for the deterioration in 1974, a continuing climb in the non-oil deficit is the sole cause of the poorer performance in 1975. The oil deficit has remained constant at a \$3.1 billion annual rate since the second quarter of 1974; the leveling off in the price of crude oil and a decline in import volume have cancelled out a drop in export earnings from petroleum products.

Madrid has become increasingly concerned about the continued strength of import demand in the face of faltering exports. Non-oil export volume plunged about 15% in the first quarter of 1975, a trend that has continued in recent months.

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Spain: Current Account Trends

	Billion US \$							
				1974 ¹				1975 ¹
	1972	1973	1974	I	II	III	IV	I
Imports ² f.o.b.	6.0	8.6	13.9	11.8	13.9	14.2	15.6	15.4
Exports ² f.o.b.	3.7	5.1	7.1	5.9	6.8	7.0	8.5	7.6
Balance	-2.3	-3.5	-6.8	-5.9	-7.1	-7.2	-7.1	-7.8
Of which:								
Oil	-0.5	-0.6	-2.8	-1.6	-3.1	-3.2	-3.1	-3.1
Services, net	2.3	2.9	3.2	3.1	3.1	3.2	3.4	3.7
Transfers, net	0.9	1.3	1.1	1.1	1.0	1.1	1.4	1.6
Current account balance	0.9	0.7	-2.5	-1.7	-3.0	-2.9	-2.3	-2.5

1. Seasonally adjusted at annual rate.

2. Customs data.

The main factors in the slump are (a) weak demand in major markets and (b) the inadequacy of a 4% trade-weighted depreciation of the peseta in the last year to compensate for Spain's high inflation rate of 19%. Non-oil import volume declined by only 5% in the first quarter, following an upward trend in 1974. In contrast with patterns elsewhere in Europe, Spanish industrial output did not begin to decline until late last year.

Only a surprising – and probably temporary – improvement in net receipts from tourism and transfer payments has kept the current account deficit close to the 1974 average. The individual tourist appears to be spending more than last year, more than making up for a decline in numbers. Transfer payments – mainly worker remittances – rose 18% in the first quarter, to \$450 million. Spanish workers are more numerous in France than in West Germany and thus have encountered lower unemployment rates than have other guest workers. Equally important, those workers returning home undoubtedly have been repatriating their savings.

Prospects

We expect Madrid to incur a \$7 billion deficit on trade account and a \$3 billion deficit on current account this year. The trade balance should show only a moderate improvement in coming months, even if imports decline in response to the industrial slowdown. Exports will remain sluggish because a strong pickup

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in US demand alone would have only a small impact and a sharp upturn in other major trading partners is unlikely. Receipts from services and transfers probably will weaken, in part because unemployment in France is expected to rise.

Foreign borrowing probably can cover much of the current account gap. Madrid has already borrowed nearly \$400 million from the IMF Oil Facility and at least \$200 million in international financial markets. It can obtain another \$660 million from the Oil Facility this year and is likely to float additional bonds on the open market. Private capital inflows may net \$300 million more, in spite of the industrial slowdown and fears of political turmoil after Franco's demise.

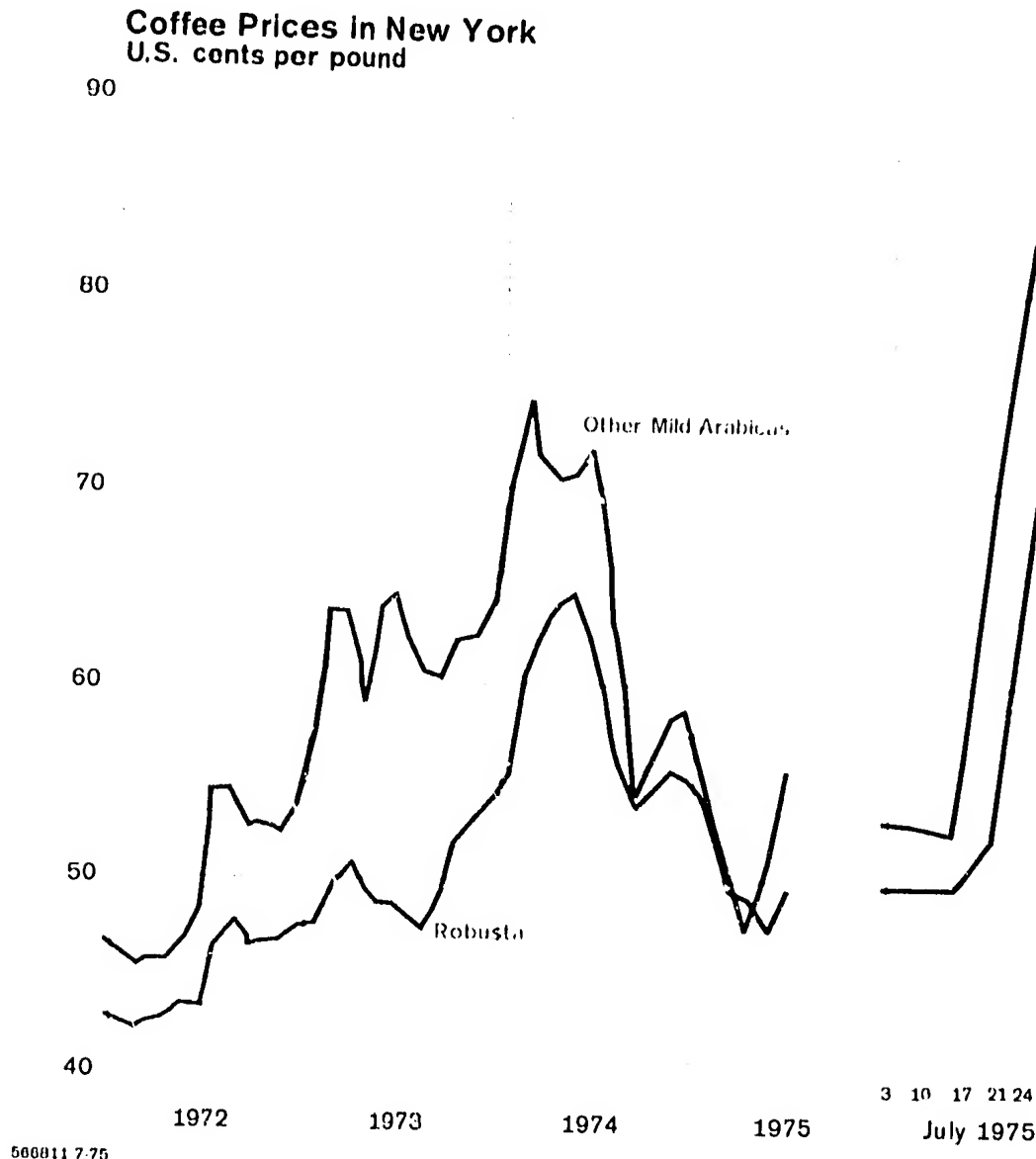
Spain's ultra-conservative policymakers may balk at another sharp increase in foreign indebtedness. The large rise in the oil bill last year boosted the foreign debt by \$900 million, to \$2.7 billion. Madrid also will resist heavy drawdowns on its foreign reserves, which have dropped \$360 million so far this year. It will be tempted instead to turn to import controls and, possibly, to export subsidies to reduce the deficit. (Confidential)■

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Note

Brazilian Frost Boosts World Coffee Prices

World coffee prices have skyrocketed following the 16-18 July frost in Brazil, one of the worst in the country's history. Price quotations for Brazilian coffee have temporarily disappeared from the market, but Central American varieties appear to have stabilized for the time being at about 83 cents per pound, 20 cents above their pre-frost level. The shock to the market was much more severe than during the 1972 frost because of the more widespread damage and the lower level of world stocks. The dramatic advance in market conditions will complicate the continuing negotiations for a new International Coffee Agreement. (Unclassified)



Publications of Interest*

Prospects for Foreign Workers in Western Europe
(CIA 9678/75, July 1975, Secret No Foreign Dissem)

This publication examines the political and economic repercussions of growing unemployment among "guest workers" in Western Europe. It analyzes (a) the negative impact on the southern countries of the return of surplus migrant workers and (b) the problems in the northern countries of the political and social assimilation of those migrants remaining.

* Copies of these publications may be ordered by calling [REDACTED] Code 143, Extension 7234.

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Cuba: Foreign Trade
(A(ER) 75-69, July 1975, Unclassified)

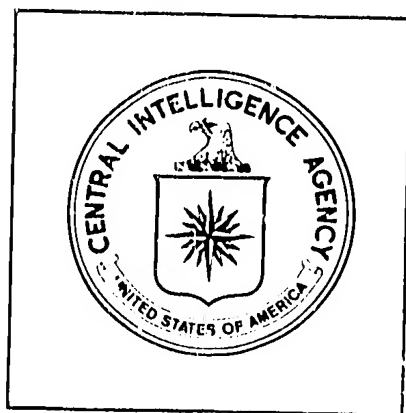
This report contains a short discussion of trends in Cuban trade since the Castro takeover in 1959, with emphasis on developments in 1974. It presents a series of statistical tables on the value, direction, and composition of trade and on economic assistance received from the USSR and non-Communist countries.

USSR: End of July Prospects for Grain Production and Trade
(ER IB 75-5, 25 July 1975, Confidential)

Continuing drought in the spring grain area has caused us to cut our estimate of this year's Soviet crop to 185 million tons and has prompted Moscow to order 14.5 million tons of foreign grain.

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ECONOMIC INDICATORS

Prepared by

The Office of Economic Research

July 30, 1975

Foreword

The *Economic Indicators* provide up-to-date information on changes in the domestic and external economic activities of the major non-Communist developed countries. To the extent possible, the *Economic Indicators* are updated from press ticker and Embassy reporting, so that the results are made available to the reader weeks - or sometimes months - before receipt of official statistical publications.

Comments and queries regarding the *Economic Indicators* are welcomed. They may be directed to [REDACTED] the Office of Economic Research, Code 143, Extension 7402 or 351-7402. **25X1A**

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